

Comments of the
New York Shipping Exchange

Submitted to the
Federal Maritime Commission

In the matter of
**Notice of Inquiry; Solicitation of Views on Requests To
Develop and Release Container Freight Rate Indices for
U.S. Agricultural Exports Based on a Sampling of
Service Contracts Filed With the FMC**

Docket No. 12-07

August 8, 2012

The New York Shipping Exchange (NYSHEX™) is an electronic trading platform that will directly facilitate improved efficiency in the international container shipping market. NYSHEX will provide importers and exporters with a fair and competitive market to purchase freight futures directly from carriers and NVOCCs. NYSHEX will also provide carriers with an efficient sales channel that enables service differentiation and fixes future volume and revenue per trade lane, which is necessary to ensure freight demand is met in the most efficient manner.

Our recommendation is that the Federal Maritime Commission (FMC) withhold from releasing any version of a container freight index. Our recommendation is based upon three principle arguments as to why a U.S. based independent shipping exchange, such as NYSHEX, would provide a better alternative to freight derivatives trading based upon an FMC generated freight rate index.

Market Context

The container shipping market has been subject to significant freight rate volatility as a result of changing market dynamics in the post liner conference era. Although the post-conference era market has reduced the margins earned by shipping lines, and consequently passed savings onto BCOs, the resulting freight rate volatility is neither in the interests of BCOs nor carriers. In some markets the freight rate volatility hinders trade more than the average freight rate savings support trade.

In order for the container shipping market to settle at a stable equilibrium, there is a need to foster basic market efficiency where carriers are remunerated for providing consistent reliable service, and BCOs are incentivized to assist carriers in optimizing their service networks. The missing key is a flow of timely information representing supply (vessel deployment and utilization) and demand (cargo readiness for shipment), where such information is received sufficiently in advance to enable the market to respond rationally and proactively.

Speculators and shipbrokers have stated that the bulk vessel charter market is similar to the container freight market and, like the bulk vessel charter market, the container freight market could benefit from index based freight derivatives. However the two markets are substantially different because the supply of container freight depends far more on the shipping lines' service networks and than it does on the supply of container vessels. Consequently, index-based freight hedging would not add efficiency to the container freight market. Instead, such hedging would remove the incentive for BCOs to work towards an optimized and stable container freight market. Furthermore BCOs would be required to pay a premium for the resulting market inefficiencies.

First Argument

U.S. export container freight rates and potential derivatives should not be viewed in isolation. Export freight rates must be considered as a function of import market conditions and specific empty container positioning flows.

Given the current imbalance in U.S. container imports and exports, back haul freight rates from the U.S. Heartland to Asia can be 20 to 40% lower than head haul freight rates Asia to the U.S. Heartland. The head haul freight rates generally cover the full shipment cost and contribute towards the cost of repositioning empty containers

back to origin markets. Whereas the back haul freight rates barely cover variable costs and draw upon repositioning credits from head haul freight rates.

Consequently, the pricing of back haul rates depends on the imbalance of head haul volumes to specific U.S. Heartland locations, or container pools. Relatively small decreases in head haul volumes to a specific container pool, or increases in back haul volumes from a specific container pool, can amplify U.S. export freight rate volatility.

The inherent problem with this relatively isolated volatility is there is no countertrade that speculators can use to hedge their exposure. Without a speculator's ability to mitigate exposure to the U.S. export freight market, he or she would only enter into a short trade with an exporter in return for a substantial risk premium, which would increase the operating cost for exporters seeking stable freight rates.

Second Argument

Carriers are essential players in the container freight markets. Without their active engagement in and support of indexes and mechanisms designed to stabilize freight rates, the markets will remain volatile.

Both carriers and BCOs have a mutual desire to achieve stable freight rates. The vast majority of BCOs want carriers to earn fair returns on their investments in exchange for providing reliable, sustainable and competitive ocean transportation. Likewise, most carriers value long-term relationships with their BCO customers, and strive to provide good service at fair prices. Despite aligned intentions, the current market context prevents the container shipping industry from achieving a stable equilibrium.

Today carriers are adamantly opposed to the use of container freight derivatives. Their rationale is that derivative traders would foster speculation within the market, in turn driving further freight rate volatility while taking a share of the industry's already slim margins.

Furthermore, if carriers continue to abstain from the freight derivatives markets, speculators will struggle to find counter parties for standard BCO hedge trades, and they will rely on relatively dirty hedges to mitigate their own exposures (for example container vessel charter derivatives or shipping line stock prices). With relatively dirty hedges, speculators will demand a greater risk premium.

Finally, since a number of the large carriers have the ability to unilaterally manipulate the supply of containerized freight (through slow steaming and other deployment options at their disposal), they have the ability to profit unfairly if they were to trade in the same derivative markets that they control or have inside information on. Any such action by a carrier would spur tremendous freight rate volatility thereby unfairly and negatively impacting BCOs.

Third Argument

The FMC can better protect the shipping public from unlawful, unfair and deceptive ocean transportation practices by regulating and monitoring a free market shipping exchange based on U.S. soil.

The two largest shipping exchanges are based in China and the U.K, namely the Shanghai Shipping Exchange (SSE) and the Baltic Exchange* (BE).

The SSE has stated their objective of “promoting RMB internationalization, raising [Chinese] national shipping status and international discourse power as well”. This appears to conflict with the FMC's mission to “foster a fair, efficient and reliable international ocean transportation system and to protect the public from unfair and deceptive practices”.

The BE have an objective to “provide independent daily shipping market information; maintain professional ship broking standards and resolve disputes”. The majority of the BE's senior management are shipbrokers, and their indexes are determined by a panel of ship brokering firms declaring their own trades. Thus their primary focus may not directly aligned with the FMC's mission.

A key tool used by the FMC to monitor and regulate fairness in the international ocean transportation system is the carrier contract filing requirement. However, the FMC has little, if any, insight into freight derivatives that are traded by U.S. importers and exporters with foreign brokers or on foreign shipping exchanges. As index based contracts become more prevalent, and if freight derivatives were to become a more common way for BCOs to hedge against freight volatility, the FMC will lose visibility of the effective rates. (The effective rate would be the rate paid to the carrier offset with the loss or gain made on freight derivatives. Without knowledge of the offset from freight derivatives, it is impossible to determine the effective rates)

Furthermore, freight derivatives traded with foreign brokers or on foreign exchanges that are not subject to FMC monitoring and regulation, expose individual U.S. importers and exporters to potentially unfair and deceptive practices. For instance, similar to the Barclays scandal where large banks were caught influencing the LIBOR, so too can large carriers influence the other derivative based indexes.

We appreciate the Commission's interest in this subject and look forward to participating in further information-gathering efforts by the Commission.

*Although the BE is currently not active in container freight derivative trading, a number of its largest ship broking firms are the chief proponents of container freight derivatives,